

VZCZCXRO0181  
RR RUEHCHI RUEHDT RUEHHM  
DE RUEHJA #9336/01 2061036  
ZNR UUUUU ZZH  
R 251036Z JUL 06  
FM AMEMBASSY JAKARTA  
TO RUEHC/SECSTATE WASHDC 7786  
RUCPDO/DEPT OF COMMERCE WASHDC  
RHMFIUU/DEPT OF ENERGY WASHINGTON DC  
RUEATRS/DEPT OF TREASURY WASHDC  
INFO RUEHXS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS  
RUEHKO/AMEMBASSY TOKYO 9927  
RUEHBY/AMEMBASSY CANBERRA 9765  
RUEHBJ/AMEMBASSY BEIJING 3535

UNCLAS SECTION 01 OF 06 JAKARTA 009336

SIPDIS

DEPT FOR EAP/IET, EB/IFD/OIA  
DEPT PASS OPIC, EXIM, TDA  
DOE FOR TOM CUTLER/PI-32 AND JANE NAKANO/PI-42  
COMMERCE FOR USDOC 4430--GOLIKE  
TREASURY FOR IA-ANDY BAUKOL

SENSITIVE  
SIPDIS

E.O. 12958: N/A

TAGS: [EINV](#) [ECON](#) [ENRG](#) [EAIR](#) [ELTN](#) [ECPS](#) [PREL](#) [ID](#)  
SUBJECT: INFRASTRUCTURE DEVELOPMENT UPDATE

REF: A) JAKARTA 2984; B) 05 JAKARTA 975

11. (SBU) Summary: The Government of Indonesia's (GOI) is making progress on a new infrastructure investment strategy. Major legislative and regulatory elements are replacing the failed pre-Financial Crisis system that relied largely on unsolicited offers by investors. The GOI has made important advances on ministerial risk-sharing and land acquisition regulations, as well as an overarching Presidential Decree. Most work has been completed on the financial risk management plan. The GOI is facing challenges in fully staffing the tender evaluation and risk sharing units within government. Business contacts, the Asian Development Bank (ADB), and some GOI officials agree that the key short-term challenge is pushing even a single project through the new system to prove it is relevant. Continued strong, high-level political backing for the Jakarta monorail project and the recently announced 10,000 MW crash electricity building program, both of which are outside the new system, raise concerns that the GOI is backing away from a rule-based, market-driven, and transparent infrastructure investment policy. End summary.

November 1-3 Infrastructure Conference  
-----

12. (SBU) Indonesia's long-delayed second national "Infrastructure Summit," now scheduled for November 1-3, has been downgraded to a series of workshops aimed at creating a few model tenders in specific sectors like airports, ports, toll roads, gas pipelines, and electricity. Senior infrastructure advisor at the Coordinating Minister for Economic Affairs, Bambang Susantono, told us that the GOI finally scuppered the previous "summit" concept, acknowledging the clear message of unhappiness from investors over the format and substance of the January 2005 Summit (reftel B). Potential investors may engage in give-and-take discussions with relevant ministers and key advisors, rather than sit through long speeches and plenary sessions. The GOI has also unofficially jettisoned its 91-project tender smorgasbord offered at the January 2005 Infrastructure Summit. Instead, Bambang told us the GOI will focus on one or two model tender projects in each of the seven core areas. The GOI is emphasizing it wants the conference to yield concrete solutions and feasible projects. The GOI has met some of the targets it set for

itself since the January 2005 Infrastructure Summit (see reftel B). However, none of our contacts could give us a precise timetable for when the various new infrastructure units throughout the government will be fully staffed.

#### Rebuilding Credibility

-----

13. (SBU) The GOI knows it bungled its initial 2005 campaign to drum up private sector infrastructure investment interest. A recent Wall Street Journal article said the January 2005 Infrastructure Summit was "widely judged as a failure by participating investors due to a lack of adequate government planning." The GOI offered domestic and foreign investors 91 projects worth \$22.5 billion: only seven have reached the tendering process and only one of those became an actual deal. Those 91 projects are still officially part of President Susilo Bambang Yudhoyono's medium-term plan for \$150 billion in infrastructure investment from 2005-2009. That investment is needed to help meet an official annual economic growth projection of 6.6 percent in the same period. The government has forecast 6.2 percent economic growth for 2006, significantly above the 5.6 percent expansion in 2005. Indonesia's infrastructure development has been lagging behind regional neighbors and is one of the most serious bottlenecks to sustained economic growth.

14. (SBU) At the February 21, 2006 conference (reftel A), the GOI announced a special stimulus package in matrix form consisting of 85 measures to remove tax, customs and excise, and labor obstacles to greater infrastructure investment. Potential investors tell us that the package is a timetable of pending regulatory changes rather than actual policy

JAKARTA 00009336 002 OF 006

initiatives, and will reserve judgment until they see the promised measures actually implemented. Foreign investors have told us and the GOI that their primary metrics to judge whether the infrastructure investment environment has improved will be keyed to: a new electricity law that explicitly permits private sector investment in electricity generation; standards for tender preparation and bid evaluation that use international best practices; and strong guarantees of international arbitration. We have annotated below the progress to date on the GOI's major regulatory changes proposed under the Policy Plan:

- Replacing Presidential Decree (Keppres) 7/1998 to create a more transparent and predictable regulatory framework for private sector participation. (Completed.)
- Revising Presidential Decree 36/2005 on land acquisition. (Completed. See paragraph 13.)
- Adopting regulations clarifying the specific roles of central and local governments on infrastructure projects. (Pending.)
- Adopting regulations on foreign loan and grants. (Pending.)
- Amending transportation laws (including land, sea, and air) relating to decentralization and regulatory functions over state-owned enterprises. (Draft law submitted to Parliament and an administration priority for the 2006 legislative session, according to the GOI.)
- Adopting regulations on the tariff policy for Public Private Partnership (PPP) projects for all modes of transportation. (Pending.)
- Implementing regulations for the Toll Road Law (38/2004). (Pending.)
- Amending Oil and Natural Gas Regulations 35/2004 (Upstream Activity) and 36/2005 (Downstream Activity). (Pending.)

- Amending Electricity and Energy laws. (Draft laws submitted to Parliament but no action expected during 2006 session.)

15. (SBU) ADB Principal Economist Ramesh Subramaniam, who is a key technical advisor to the Finance Ministry, told us he doubts the feasibility of getting one quality tender project in each of the seven sectors by the November conference date. Subramaniam said that he has advised the GOI to sharpen its focus further still. The ADB has told the GOI at several levels that it would reap far greater benefits from one or two well planned and credibly implemented infrastructure projects using world-class best practices, than from another large conference seeking a dozen tenders across seven sectors. (Comment: Embassy has given the same advice for many months. End comment.) Subramaniam said that the GOI remains wedded, however, to the key short-term objective of getting high quality bidding documents for one or two projects in each of the seven sectors. He said that international, best-practice tender documents require specific terms of reference for each infrastructure sector. They must also be prepared by people with highly technical skills and specialized knowledge. For this reason Vladimir Bohun, a retired ABD employee who is currently an ABD-funded Senior Infrastructure Advisor at the State Ministry for National Development Agency (BAPPENAS), said he believed even seven projects was too ambitious if the GOI wants to follow international best practices.

#### New Regulatory Structure

-----

16. (SBU) The key challenge for the GOI is to assure that its offers of partial or full government support are limited to high-quality projects. It has created an elaborate system to evaluate both project tenders and possible government support. Sitting atop the structure is the National

JAKARTA 00009336 003 OF 006

Committee for the Acceleration of Infrastructure, known by its Indonesian acronym KKPPI. It is composed of line ministers from the relevant constituent sectors, such as energy, public works, and transport, and chaired by the Coordinating Minister for the Economy Boediono. (Note: Sixteen line ministries report to Minister Boediono. End Note.) The ministerial committee will be supported by a secretariat of professional staff split between the Office

#### SIPDIS

of the Coordinating Minister of the Economy and BAPPENAS. Each line ministry in turn will have a "Public Private Partnership Node," which will be responsible for vetting preferred projects to assure that only priority projects and high-quality bid packages are forwarded to the KKPPI for consideration. The contracting agency within each ministry will have a PPP Node, according to the plan. For example, state electricity company PLN, downstream regulatory agency BPH Migas, and state gas company PGN are all scheduled to have their own PPP Node within the Ministry of Energy and Mineral Resources.

17. (SBU) The jobs in PPP Nodes are to be full-time within each Ministry, though none are currently staffed. Susantono said the KKPPI secretariat and the nodes in the Ministries of Public Works, Transportation, and Energy and Mineral Resources are all slated to be up and running by the end of July. Bambang said that Minister Boediono will convene cabinet principals in July to re-evaluate the GOI's infrastructure targets and set their work program in preparation for the November conference.

#### New Risk Sharing Package for Infrastructure

-----

18. (U) On June 2, the GOI announced important new guidelines

for financial risk-sharing for PPP infrastructure projects. The guidelines were overdue and had been originally promised by the GOI for completion in March. The final regulation, issued as Finance Ministry Decree 38/2006 ("Implementation Instructions for the Control and Management of Infrastructure Provision Risks"), covers risk sharing for PPP infrastructure projects in the energy, transportation, telecommunications, water resources, and housing sectors. The types of risk covered are:

-- Political risk: policies, actions, or decisions taken by government or state entities that directly and significantly impose financial losses on a business enterprise through expropriation, legal or regulatory change, currency convertibility restrictions or funds repatriation prohibitions.

-- Project Performance Risk: Risk associated with project implementation, which includes location risk and operational risk.

-- Demand Risk: When demand for goods or services produced are lower than agreed. (Note: The GOI will also structure risk sharing agreements so that they share in the upside risk if demand greatly exceeds forecasts.)

Risk Management Unit and KKPPI Staff Pending  
-----

¶9. (SBU) Officials at the Ministry of Finance (MOF) on the Risk Management Committee told us that they were unsure when the dedicated Risk Management Unit would be established. The current committee, which serves on an ad-hoc basis in addition to normal duties, will continue during the transition period. Officials expected that a draft Presidential Decree on the overall reorganization of the MOF would include the new Risk Management Unit. They were unsure if the Risk Management Unit would be housed under the Directorate for Debt Management or the Directorate for Fiscal Policy.

Process and Decision-Making for Risk Sharing  
-----

¶10. (SBU) The process for securing GOI risk-sharing support

JAKARTA 00009336 004 OF 006

as outlined in the decree is close to what Minister Boediono announced at the February 21 conference (reftel A). The line ministries will propose PPP infrastructure projects to the KKPPI, providing a pre-feasibility study; a plan of the form of public-private cooperation or risk-sharing; a plan for project financing; a schedule and evaluation process; and documentation of the results of public consultation on the proposed project. KKPPI will then evaluate the proposal according to publicly announced criteria and transparent priorities. After being favorably evaluated for feasibility and priority-ordered by the KKPPI, the MOF Risk Management Unit will evaluate the project's suitability for government support. If the MOF concurs with government support, it will decide an appropriate level of risk exposure and request budget approval from Parliament. Currently the GOI has decided that it will submit projects in groups for budget approval by Parliament, but it is still deciding whether to submit projects more frequently annually. Once the Parliament has approved the funds, the project will then be tendered, with the MOF having the final say on approval, as a means to provide quality control over the tender process.

Industry Reaction Mixed  
-----

¶11. (SBU) Officials at the Ministry of Finance on the Risk Management Committee said that the initial reaction from the private sector was that it wanted more types of risks

covered. Members of the American Chamber of Commerce (AMCHAM) tell us that they like the preliminary descriptions of how the program will work, but they will be watching carefully how the MOF implements it. Vladimir Bohun said he hopes that the GOI will simply describe the risk it is willing to share and then leave it to the private investors to offer their bids for what they need. This will allow maximum flexibility for businesses to be creative while ensuring that the GOI gets the best terms for its risk. Potential investors tell us they feel the initial \$217 million requested for risk-sharing by Minister Mulyani in May is too little to attract serious foreign participation, particularly on larger infrastructure projects.

#### World Bank, ADB Infrastructure Involvement

-----

¶12. The GOI has requested World Bank and ADB assistance in financing infrastructure development through a \$400 million Development Policy Loan (DPL), \$300 million of which will come from the ADB and \$100 million from the World Bank. The DPL would not be tied to specific sectors or projects, according to our World Bank contacts. The DPL consists of three consecutive reform programs to be implemented by the GOI through 2009. The programs will aim to assist the GOI in legal and institutional reforms, policy reforms in specific sectors (e.g. transportation, oil and gas, telecommunications, water and sanitation), and a transparent bidding process. World Bank and ADB contacts tell us they will only make subsequent disbursements if the GOI shows real progress within agreed time frames. Our World Bank contacts tell us the GOI will need to demonstrate it can implement a well-structured model transaction. In particular, the World Bank and ADB will closely monitor the effectiveness of the Risk Management Unit and the KKPPI project evaluation process. The GOI faces a significant challenge, as our World Bank and ADB contacts continue to uncover fresh examples of pressure by well-connected local investors who are seeking to undermine the role of the KKPPI on infrastructure projects.

#### Land Acquisition Decree

-----

¶13. (SBU) Uncertainty and bottlenecks related to land acquisition have delayed or sunk infrastructure projects in the recent past. Land title issues are problematic in Indonesia, with only a fraction of land having clear legal title. In addition, rising land prices spurred by speculators and rent-seekers with inside information have

JAKARTA 00009336 005 OF 006

been a perennial problem in the Indonesian infrastructure sector. The new decree will handle land issues under project performance risk. The GOI may compensate delays in land acquisitions by extension of the concession period or by other unspecified means approved by the Minister of Finance if the GOI has caused the delays. The GOI may also compensate increases in land prices by extending the concession period, paying a percentage of the higher price, or by other unspecified means approved by the Minister of Finance.

¶14. (SBU) The GOI made only minor changes to the initial draft presidential decree on land acquisition for infrastructure projects, which President Yudhoyono signed on June 6. Investors are likely to welcome the changes, while anti-corruption NGOs and legislators continue their drumbeat against it. Public Works Minister Djoko Kirmanto said in early June the revisions had been finalized with several contentious articles dropped.

¶15. (SBU) The decree allows the government to take over government land for projects deemed in the public interest, as well as the ability to strip private land owners of their property rights if they do not agree to government



compensation offers. Legislators and NGOs which opposed the new decree said it is too vague in its definition of "public interest" and violates landowners' rights under the 1962 Property Law. They say they fear the new legislation will be abused by government officials to take private land arbitrarily. Critics argue also that the new system, with an independent land assessor appointed by the government, provides too many incentives for collusion between officials and business interests. They also criticized the deadlines the decree sets for property negotiations, which they said could force landowners to accept unfair compensation offers. Still, the GOI has created a process by which landowners can appeal compensation offers that they view as inadequate. Previously, no such right of appeal existed. Potential infrastructure investors are likely to applaud the speed of the process and its streamlined nature.

¶16. (SBU) The GOI did significantly scale back the types of infrastructure projects for which investors may seek a public interest designation. The GOI initially considered including 21 categories but settled on roads, freeways, dams, airports, railways and flood dikes, according to the Public Works Ministry. It specifically excluded telecommunications infrastructure. "There has to be a mechanism that stops people from holding the government hostage over important infrastructure projects, Communications and Information Minister Sofyan Djalil told reporters recently. He added, "At the moment, we see people blocking roads because they don't want to give up their land to the government. The state needs a law to ensure the process is expedited."

Comment

-----

¶17. (SBU) The GOI has been working hard in certain areas, namely in coming up with the financial risk-sharing mechanism. The amount of money the GOI has allocated for risk-sharing does not match the ambitious goals it has set, according to most knowledgeable infrastructure observers. We do believe it will be sufficient to get one model transaction done. More troubling is the many ways in which the GOI is working at cross purposes. For example, the recently announced crash electricity building program to add 10,000 MW of generating capacity by 2009 will be done mostly by direct offer, rather than through a competitive, transparent bidding system. Vice President Kalla has made vague public comments that the GOI may extend some form of government support to the companies participating in the crash program, similar to the "comfort letters" of the past. Extending selective government support to the companies involved in the crash program or the Jakarta monorail project would undermine Indonesia's attempts to show foreign investors that they have a fair and transparent system based on international best practices.

JAKARTA 00009336 006 OF 006

PASCOE